

## Best Practices for Market-Based Systems

The Environmental Markets Association (EMA) strongly supports cap-and-trade legislation as the most environmentally-protective, cost-effective, and technologically-innovative policy approach to limit greenhouse gas (GHG) emissions. EMA members have decades of extensive, first-hand experience with cap-and-trade initiatives, including the Clean Air Act's groundbreaking 1990 acid rain program that has decreased sulfur dioxide (SO<sub>2</sub>) emissions by 52% from 1990 levels and abatement costs reduced to an estimated 43%- 55% due to the flexibility inherent in trading. The price signals created by that U.S. initiative have spurred technological innovations to optimize both environmental and economic efficiencies. Its overwhelming success makes EMA confident that a GHG cap-and-trade program will similarly ensure that GHG emissions will fall, unleash market forces to settle on the most cost-effective means to reduce GHG emissions, and precipitate a revolution of innovation in energy efficiency and GHG emission reduction technologies.

EMA endorses the following principles in support of a GHG cap-and-trade program.

### **1) Market based cost containment**

Economic analyses decisively demonstrate the importance of credible GHG offsets in modulating and containing the cost of complying with a federal GHG cap. EMA supports the goal of attaching an effective market-driven price on GHG emissions so as to encourage innovation and emission reductions, while at the same time making available a sufficient number of domestic and international offset credits to temper the volatility and cost of GHG allowances in a U.S. carbon market.

### **2) Market oversight and regulation**

EMA supports appropriate regulation and oversight of environmental markets designed to maximizing the ability of companies to manage their risks while minimizing systemic risk. Appropriate regulation and oversight should include measures to encourage transparency and broad participation, while guarding against fraud and manipulation. Such measures may include provision of centralized clearing mechanisms for standardized contracts, as well as additional reporting requirements for non-standard agreements.

### **3) Transparent accounting and measurement systems to provide accurate price discovery**

Market design infrastructures have an essential and significant impact on the effectiveness and efficiency of every environmental market. EMA promotes market design infrastructures that create reliable, accurate and publicly-available price signals capable of facilitating market or auction objectives to channel the allowance or offset units to the participants who most highly value them. Design components should ensure that all participants have both an incentive and interest to ensure that efficient price discovery occurs and is revealed to the market in a timely and transparent manner.

### **4) Economically and scientifically driven targets**

The stringency of GHG emission reduction targets should reflect equilibrium between the economic costs of inaction and the economic costs of action, with both sets of costs informed by the latest and most sophisticated scientific and economic evidence and technological development. EMA supports the goal of using the best scientific evidence to set GHG emission reduction targets at levels no more stringent than necessary to avoid preventable economic harm from high GHG levels.

### **5) Clear rules with long-term and consistent policy signals**

Long-term regulatory and policy certainty will allow a robust market-based system to evolve with price discovery and liquidity. Constantly changing rules creates uncertainty and stifles market development. EMA supports legislative and rulemaking efforts to establish a complete, defined and transparent market regime for the long term. Moreover, EMA also promotes the inclusion of experienced market participants at all stages of the development process. Concerted stakeholder engagement and consultation will have a dramatic impact on the ultimate strength and vibrancy of the market.

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### **6) Driving American innovation through a price on carbon**

The next great global economic expansion will be an international race for sustainable energy, low carbon efficiencies, and technological invention. American competitiveness in this race will be determined by policies that put a market-based price on carbon emissions and other environmental attributes. EMA supports federal cap-and-trade legislation as the best mechanism to provide that price signal at the lowest cost to the consumer. An effective federal program will attract capital and harness the power of American enterprise to lead the world toward GHG emission reduction innovation and sustainability.

### **7) Recognition for early action**

EMA supports maximum recognition of efforts undertaken by entities to reduce their carbon footprint prior to enactment of federal cap-and-trade legislation, provided proper documentation of such “early action” is required and observed. Early action should be rewarded with allocation of fully fungible offsets or allowances. Moreover, state and regional programs should be integrated into the federal program and recognized for early action.

### **8) Environmental integrity with sensible tradeoffs between precision and cost**

The ability to certify that a GHG emissions reduction is real and additional is critical to underwriting the quality of an emission offset offered for sale. At the same time, there are significant up-front costs to development of procedures to certify emission reductions which can serve as an obstacle to a fully functioning market.

### **9) Harmonize standards with international and existing domestic program linkages**

From an ideal carbon market perspective, one ton of GHG emissions should be indistinguishable from, and tradable with, any other ton. But no unitary carbon market exists. Fungibility relies on policy and regulatory harmonization of relevant carbon standards, metrics, and methodologies. EMA therefore supports all policymaking efforts to facilitate or engender seamless regulatory infrastructures between national and international market regimes. Broad inter-market cooperation will dramatically enhance liquidity and reduce overall market costs.

### **10) Encourage market liquidity and broad market participation**

EMA supports broad participation in environmental markets, since a competitive market containing a large number of buyers and sellers 1) reduces liquidity risk and 2) ensures that no one entity can influence the market. Any regulation that could potentially increase the cost for participants should be carefully evaluated as to its impact on market liquidity. Furthermore, EMA does not support efforts to limit participation in environmental trading markets or allowance auctions to only those confronted with compliance issues.

### **11) System level fungibility and temporal bankability**

EMA supports maximizing banking and borrowing of emissions allowance and offsets based on clear and auditable rules. Banking results in environmental reductions earlier than expected as well as demonstrable cost savings. The inability to carry-forward allowances can act as an added mitigation mechanism against market price volatility.